

Massachusetts Bankers Association

July 12, 2004

Ms. Jennifer Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
regs.comments@federalreserve.gov

SUBJECT: Risk-Based Capital Standards: Trust Preferred Securities and the Definition of Capital, Docket No. R-1193

Dear Ms. Johnson:

The Massachusetts Bankers Association (“MBA”), which represents 220 commercial, savings, and cooperative banks and savings and loan members in Massachusetts and New England appreciates the opportunity to comment on the Board of the Federal Reserve Systems’ (“Board”) above referenced proposal. The MBA supports the proposal, with some changes, which would allow the continued inclusion of outstanding and prospective issuances of trust preferred securities in Tier 1 capital for bank holding companies subject to new limitations.

Background and Proposal

In 1996, the Board approved the inclusion of bank holding companies (BHC’s) Tier 1 capital of minority interest in the form of trust preferred securities based on factors such as their qualification under generally accepted accounting principles (GAAP), ability to absorb losses more broadly in the consolidated banking organization and competitive equity factors. As a result of recent changes in the accounting treatment of trust preferred securities, the Board has issued the proposed changes to its rules.

Under the proposal, the Board would allow BHC’s to continue applying existing rules which permit up to 25% of trust preferred securities and cumulative perpetual preferred stock in Tier 1 capital. After March 31, 2007, BHC’s would have to deduct goodwill from their Tier 1 capital before calculating the 25% limit. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, up to 50% of a banking organization’s Tier 1 capital. Internationally-active BHC’s would generally be expected to limit trust preferred securities and certain other capital elements to 15 % of Tier 1 capital elements, net of goodwill.

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MBA position

The MBA commends the Board for its efforts to strengthen the definition of regulatory capital for bank holding companies while acknowledging that trust preferred securities are an important instrument for financial institutions. Our members consisting of a majority of small- to medium-sized community banks and a few large regional banks utilize trust preferred securities as an important way to free up and/or lower the cost of after-tax capital. We commend the Board for continuing to permit the inclusion of trust preferred securities in Tier 1 capital.

The MBA believes the deduction of goodwill is not necessary. However, if the Board wishes to proceed, it should be noted that the proposed changes will not apply to savings associations. Finally, we wish to comment on the proposed three-year transition period for BHC's to meet the new stricter requirements. The MBA believes that a five year transition would provide BHC's more time to accommodate longer-term binding contracts dating back to as early as 1996 when the Board initially permitted the use of trust preferred securities in Tier 1 capital. In addition, we would also comment that the Board does not need to formalize the standard that internationally-active banks limit their inclusion of innovative products such as trust preferred securities to 15% of Tier 1 capital. As the Board has acknowledged in its proposal, internally-active large banking organizations are subject to more rigorous market discipline and do not exhibit excess reliance on trust preferred securities or other similar instruments.

While this ruling is important for all member banks, it is particularly meaningful to Massachusetts banks in mutual governance form which would otherwise rely on retained earnings as the sole means of capital. By utilizing trust preferred securities, mutual banks can pursue growth strategies which require extra capital without changing their mutual status: a critical benefit for local communities and banks alike.

We encourage the Board to work with other banking regulators to encourage continued acceptance on the treatment of trust preferred securities in Tier 1 capital.

Thank you for the opportunity to submit comments on the proposal.

Sincerely,

Tanya M.
Duncan

Tanya M. Duncan
Director, Housing and Federal Policy

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